APPENDIX.

Opinion of the United States Court of Appeals.

United States Court of Appeals, for the Second Circuit.

No. 55—September Term, 1966.
(Argued September 27, 1966
Decided October 10, 1966.)

Docket No. 30491

Estate of Max Steinberg, Deceased, Pearl Steinberg, Executrix and Pearl Steinberg, Individually, Petitioners, against Commissioner of Internal Revenue, Respondent.

Before:

Moore, Friendly and Kaufman, Circuit Judges.

Appeal from the decision of the Tax Court, Austin Hoyt, *Judge*, that there were deficiencies in income taxes due from the petitioners for the taxable years 1950 and 1951.

Affirmed.

George T. Altman, Beverly Hills, California, for petitioners.

Mitchell Rogovin, Assistant Attorney General (Meyer Rothwacks, John P. Burke, Attorneys, Department of Justice, Washington, D. C., on the brief), for respondent.

Moore, *Circuit Judge:*

Max and Pearl Steinberg (Petitioners) were married in 1942. The Commissioner of Internal Revenue (Commissioner) determined deficiencies against Max for the years 1947, 1948, and 1949, when Max and Pearl filed separate returns, and against both for 1950 and 1951, when they filed a joint return. Petitioners

petitioned the Tax Court for a redetermination of the deficiencies. The assessment of a deficiency for each year concerned was barred by the statute of limitations unless the return for that year was fraudulent. The burden of showing fraud was on the Commissioner. A decision of no deficiency was entered for the years 1946, 1947, and 1948, but deficiencies were determined against petitioners for 1950 and 1951. Only the latter determination is appealed from.

Since Max died shortly after the trial in the Tax Court, Pearl alone prosecutes this appeal in her own right and as executrix of Max's estate.

Petitioners claim that the Commissioner has not met his burden of proving fraud. We disagree. By using the "increase in net worth" method, the Commissioner showed that petitioners received income which they did not report in 1950 and 1951. The net worth figures were the result of an extensive investigation by government agents into the financial affairs of both Pearl and Max, and included the assets and expenses of both of them. The investigation did not reveal the source of the income. Petitioners claimed that Pearl had a substantial cash hoard accumulated in years prior to 1946, the investment and expenditure of which during the years 1946-51 accounted for the increase in net worth. They claimed many non-taxable sources of the cash, but a careful investigation invariably revealed that the claims were untrue.

The Tax Court felt, and we agree, that fraud had been established by the petitioners' insistence upon giving the government agents false leads as to the source of the alleged cash hoard, and by the use of camouflaged and hidden bank accounts.

Testifying before the Tax Court as an adverse witness called by the Commissioner, Pearl asserted for the first time that the source of an undetermined portion of the cash hoard was a prominent gentleman whom she had hoped to marry but who had died in 1931. She testified that for several years he had periodically given her little bags of money which she had placed unopened and uncounted in a safe deposit box. She refused to reveal his identity because of a promise not to do so. Because of this refusal, this testimony was stricken. Petitioners claim this was error. Even if petitioners are correct, which we need not decide, they were not prejudiced by the action. The same court which ordered the testimony stricken said later, in its finding of facts:

> "Even if all of her testimony were still before us, we would reach the same conclusion. We observed her demeanor on the witness stand and have compared her tale of the unnamed suitor . . . with her previous statements as to the source of her cash accumulations. We could not give credit to her account even if she had candidly identified for the first time at trial her phantom friend, and certainly her failure to disclose the alleged amount of her cash hoard renders the testimony almost valueless for purposes of an attack on the net worth computation." 24 T. C. M. at 1254.

Petitioners' final complaint is that the Commissioner's answer in the Tax Court did not advise the petitioners fully of the nature of the defense as required by Rule 14(b) of the Tax Court. Specifically, petitioners claim they did not know that the Commissioner was relying on increases of combined net worth due to Pearl's in-

come. The Commissioner's answer before the Tax Court leaves no doubt that he did not know where the unreported income came from, and that he had no intention of limiting his basis for deficiencies to unreported income generated by Max alone. Thus, petitioners' claim that the answer was insufficient to support a determination of deficiencies based on income generated by Pearl is without merit.

Affirmed.

Excerpts From Commissioner's Answer in the Tax Court.

7. Further answering the petition, respondent alleges affirmatively as follows:

. . . . .

(c). During the taxable year 1950 the petitioners received income from petitioner Max Steinberg's business, investments, and/or other sources not disclosed in their income tax return in the amount of $38,733.75, which amount is represented by an unexplained increase in petitioners' net worth for said taxable year as set forth in the year designated in the computation of income annexed hereto and made a part hereof as Exhibit 1.

. . . . .

(e). During the taxable year 1951 the petitioners received income from petitioner Max Steinberg's business, investments, and/or other sources not disclosed in their income tax return in the amount of $33,626.77, which amount is represented by an unexplained increase in petitioner's net worth for said taxable year as set forth in the year designated in the computation of income annexed hereto and made a part hereof as Exhibit 1.

Quotation From "Brief for Respondent" in the Tax Court—Last Paragraph Page 52, First Paragraph Page 53, Thereof.

In summary, there is no evidence in the record of non-taxable income received by either Max or Pearl Steinberg, except $2,500 to Pearl Steinberg from Harry B. Davis' estate in 1929 and $1,500 received by Pearl Steinberg from her mother's estate in 1932. Further, there is not even a hint of a source of taxable income to Pearl Steinberg during the taxable years involved, other than the income reported by her. Finally, there is a strong possibility of a taxable source of income to Max Steinberg.

By reason of all the foregoing respondent submits that the increases in net worth represent taxable income to Max Steinberg for 1947, 1948 and 1949 and taxable income to Max and Pearl Steinberg for 1950 and 1951. Respondent further submits that the evidence is clear and convincing to prove his determination of fraud.